

E-017/M-90-512 ORDER APPROVING TARIFF AND REQUIRING FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of the Proposal of
Otter Tail Power Company for a
Large General Service Time-of-
Use Tariff

ISSUE DATE: February 26, 1993

DOCKET NO. E-017/M-90-512

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PROCEDURAL HISTORY

On May 27, 1987, the Commission issued its FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER in the latest general rate case¹ filed by Otter Tail Power Company (Otter Tail or the Company). In that Order the Commission directed Otter Tail to work with the Department of Public Service (the Department) to develop a proposal for time of use (TOU) rates for large general service (LGS) customers.

On December 30, 1987, the Commission issued its ORDER APPROVING TIME OF USE RATES PROPOSAL. In that Order the Commission approved Otter Tail's TOU proposal, which included a one year test period.

After a number of revisions to Otter Tail's TOU proposal and comments from the Department, the Company filed its fourth TOU proposal on March 30, 1992.

The Department filed comments regarding Otter Tail's latest TOU proposal on June 25, 1992. The Company filed responsive comments on September 8, 1992, and filed a new set of proposed TOU tariffs on October 29, 1992.

On November 4, 1992, the Department filed further comments regarding Otter Tail's TOU proposal.

The matter came before the Commission for consideration on January 28, 1993.

¹ In the Matter of the Petition of Otter Tail Power Company for Authority to Increase Rates for Electric Service in Minnesota, Docket No. E-017/GR-86-380.

FINDINGS AND CONCLUSIONS

Otter Tail's TOU Proposal

Otter Tail proposed an optional TOU tariff with a minimum contractual period of one year. The rates include peak and off-peak demand charges and peak and off-peak energy charges but do not vary by season.

According to Otter Tail, it used the following criteria in designing the proposal:

1. Revenue neutrality;
2. Peak to off-peak energy charge ratio of at least 1.5;
3. A rate that is easy to understand and practical for both LGS customers and Otter Tail;
4. Avoidance of major seasonal revenue shifts;
5. Energy charges which do not fall below marginal costs;
6. Summer rate components which do not exceed winter rate components.

In order to produce a meaningful differential between the peak and off-peak energy charges, Otter Tail allocated a portion of the demand costs to the energy charges. The Company started with a level of \$8.72/kW, the bottom limit of summer demand costs identified in the Company's marginal cost study. The remaining demand costs were assigned to the peak energy charges. The establishment of a 75% demand ratchet eventually allowed the demand charge to be reduced to \$8.52/kW.

The Company included a special provision in the TOU rate which charges 50% of the peak demand charges if the customer's off-peak demand exceeds 125% of the customer's coincidental peak.

To set energy charges, the Company began with the premise that a price of at least 2.1 cent/kWh was necessary to assure cost-recovery on each kWh sold. The off-peak energy charges were set at this level.

The Company then sought to establish a meaningful peak to off-peak price differential, so that high-load factor customers can benefit from shifting a portion of their load from the peak period. Although it represented a move away from incremental cost, a peak to off-peak price differential was established by shifting a portion of peak demand costs to peak energy charges. The Company's final peak to off-peak energy charge ratio was 1.5.

Comments of the Department

The Department stated that the proposed Otter Tail TOU rate should meet the following criteria:

1. The rates should reflect as closely as possible the Company's incremental costs; this goal would promote economic efficiency, conservation and the appropriate allocation of costs;
2. The rates should have as small effect as possible on total LGS revenues;
3. The rates should be easy to administer and be well understood by customers;
4. Although the Department believed that a mandatory TOU tariff would be better than a voluntary tariff, the Department stated that it would not object to the implementation of a voluntary tariff at this time.

The Department stated that a company's pricing goal should be to recover both generation and transmission demand costs through the peak demand charges. Because Otter Tail's proposed off-peak demand charges do not reflect the incremental distribution costs, the Department recommended disapproval.

Based on the ratio of peak to off-peak incremental capacity costs, the Department believed that the ratio of peak to off-peak demand rates for primary and secondary service should be at least 2.5, if no seasonal differential was established.

The Department agreed with the Company's equal allocation of incremental capacity costs between the summer and winter seasons. The Department also agreed that a 75% demand ratchet is appropriate.

The Department stated that Otter Tail's proposed energy rates are much higher than the incremental energy costs for both seasons. The Department recommended that all peak energy rates be reduced to better reflect the Company's incremental energy cost. Based on the ratio of peak to off-peak marginal energy costs, the Department recommended that the ratio of peak to off-peak energy charges be capped at 1.2 rather than 1.5 as proposed by the Company.

Commission Analysis

The Commission notes that both the Department and Otter Tail are pursuing reasonable goals by means of their TOU rate design proposals. According to the Department, moving rates as close as possible to incremental costs is the overriding goal, since this will promote the most efficient use of resources. Otter Tail claims that upon occasion it must deviate from its general trend toward incremental costs in order to achieve revenue neutrality,

increase rate stability and promote efficient load shifting by creating a peak and off-peak rate differential.

The Commission notes that a seasonal differential would usually be the best reflection of the cost of providing service, but is not appropriate in this case. Although Otter Tail would otherwise be deemed a winter peaking utility, it has entered into an exchange agreement with Northern States Power Company (NSP) whereby Otter Tail will provide NSP with 75 MW of capacity in the summer and NSP will provide 75 MW in the winter. Thus, Otter Tail will need additional summer capacity in years when it is projected to have sufficient winter capacity. Because of the agreement, a seasonal differential with a lower summer rate is not appropriate because it would only increase the Company's capacity shortage. A seasonal differential with a lower winter rate is not appropriate because the NSP/Otter Tail capacity agreement will terminate in 2004.

The Commission has looked carefully at the arguments of both parties and finds that it will approve this TOU rate proposed by Otter Tail. The Commission notes that the Company does not currently offer a TOU rate to the LGS class, and the class will likely remain small after the rate is adopted. The Company has apparently designed the rate with knowledge of its potential customers and of its capacity. Under the facts now before the Commission, Otter Tail is best able to design this TOU rate proposal.

Because the Department raised reasonable concerns regarding this filing, the Commission wishes to monitor the new TOU rate for some time. The Commission will therefore require Otter Tail to submit annual reports regarding its TOU rate. The annual filings should inform the Commission of the status of the customers partaking of the new TOU rate, their number and demand, and of the effects of the tariff.

ORDER

1. Otter Tail's proposed TOU rate is approved.
2. On or before one year from the date of this Order, and on an annual basis thereafter, Otter Tail shall file a report on the status of customers on the TOU rate, their number and demand, and the effects of the tariff.
3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

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